OCT 4 1951

IN THE

Supreme Court of the United States

NO. 367

ACF-BRILL MOTORS COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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INDEX.

	PAGE
Opinions Below	2
Jurisdiction	2
Question Presented	2
Statutes and Regulations Involved	2
Statement	3
Specification of Errors to Be Urged	7
Reasons for Granting the Writ	7
Appendix	13

CITATIONS.

Cases:

American Bantam Car Co. v. Comm., 177 F. 2d 513	11
Helvering v. Bashford, 302 U.S. 454	7, 8, 9
Helvering v. Southwest Co., 315 U.S. 199	11
Kimbell-Diamond Milling Co. v. Comm., 187 F. 2d 718	11
S. Klein on the Square Inc. v. Comm., 188 F. 2d 127	11
National Bank of Commerce in Memphis v. U. S., 180 F. 2d 356	11

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

ACF-Brill Motors Company by its counsel, John E. Hughes, John W. Hughes and Harold R. Burnstein, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Third Circuit entered in this case.

Opinions Below.

The opinion of the Tax Court (R. 63a) is reported in 14 TC 263. The opinion of the Court of Appeals (R. 87) is reported in 189 F. 2d 704.

Jurisdiction.

The judgment of the Court of Appeals was entered on June 7, 1951 (R. 92). A petition for rehearing was filed on June 21, 1951 and was denied, without opinion, on July 11, 1951 (R. 99). The jurisdiction of this Court is invoked under Section 1254(e) of Title 28, United States Code.

Question Presented.

When American Car & Foundry Securities and Brill bought the stock of Hall-Scott Motor Car Company for $3,000,000 with the purpose (admitted by respondent in his brief in the Court below) of organizing taxpayer and transferring that stock to it, by carrying out such purpose they clearly invested $3,000,000 in the taxpayer. The theory of the invested capital credit for excess profits tax is that a corporation is entitled to earn from 5 per cent to 8 per cent of the investment made in the corporation by its stockholders before any of its profits are treated as "excess." By breaking the one transaction into two steps and giving each step separate tax effects, the decision below allows the taxpayer to include in its invested capital only $100,000 for all the Hall-Scott stock acquired by it for $3,000,000.

The question presented is whether a complicated corporate reorganization effected in a number of steps should be treated as one transaction or broken up into its separate steps and each be given separate tax effects.

Statutes And Regulations Involved.

The statutes and regulation involved are printed in the Appendix, pages 13 to 14.

STATEMENT.

Petitioner is the successor by merger of American Car and Foundry Motors Company (hereinafter referred to as the taxpayer) with the Brill Corporation. Taxpayer filed consolidated corporation income and excess profits tax returns under the provisions of Section 141 of the Internal Revenue Code for the calendar year 1943 on behalf of itself and its wholly-owned subsidiaries which included Hall-Scott Motor Car Company and Fageol Motors Company. (R. 64a-65a)

In the year 1925 it became apparent to the officers of American Car & Foundry Company, a manufacturer of railroad cars and equipment, and the J. G. Brill Company, a manufacturer of interurban and street railway cars, that the street railway business was on the downgrade and that the manufacture and sale of buses was becoming increasingly important. Hence, W. H. Woodin, president of American Car and Foundry Company, and S. M. Curwen, president of the J. G. Brill Company, became interested in the manufacture of buses. They commenced activities to procure that type of business almost immediately. (R. 65a)

The bus manufacturing business required two things, the ownership of a good engine and the ownership of the necessary skill, technique and plant required for the manufacture of bus bodies. Neither the American Car & Foundry Company nor the J. G. Brill Company had any experience in the manufacture of either a bus engine or a bus body. The plan was to enter the bus manufacturing business through the purchase of both a manufacturer of an engine and a manufacturer of bus bodies.

In June, 1925 Woodin and Curwen commenced negotiations to acquire the assets or the controlling interest of stock of the Hall-Scott Motor Car Company, a manufac-

turer of a well-known engine for buses, the Fageol Motor Company of California and the Fageol Motor Company of Ohio, manufacturer of bus bodies. (R. 65a) As respondent admitted in his brief in the Court of Appeals, the plan decided upon was to organize a new corporation which was to acquire all the stock of these companies. Active in this plan were the officers of the Hall-Scott Motor Car Company, E. J. Hall, B. C. Scott and L. S. Scott. Mr. Hall was to be Vice President of the new company in charge of Engineering and Production and all were to have a large stock interest in the new company. Mr. F. R. Fageol, main stockholder of Ohio Fageol, was to be the Vice President in charge of Sales of the new company. The details of the previously made plan were set out in a memo dated September 1, 1925 (before the Hall-Scott stock was bought), which was attached to the minutes of a meeting of the Brill Board of Directors dated September 8, 1925 and read in part as follows (R. 39a-41-a):

> "The American Car & Foundry Company and The J. G. Brill Company have been working for some time to arrange a consolidation between the Hall-Scott Motor Car Company, Incorporated, of Berkeley, California, builders of the well-known Hall-Scott engine and the Fageol Companies (Fageol Motor Company of California, Oakland, California and Fageol Motors Company of Ohio, Kent, Ohio) who have had exclusive right to use this engine in busses built by them.
>
> "To enable such a consolidation to be made, the Car Companies are willing to invest at least $3,500,000.00 in a new consolidated company.
>
> "It is proposed to form a new company to be called the Fageol-Hall-Scott Company (or some other appropriate name) having an authorized capital stock of $10,000,000.00 preferred stock and 150,000 shares of common stock of no par value.
>
> "The car builders have purchased the control (66 2/3%) of the Hall-Scott Company, practically all the remaining stock being retained by Col. E. J. Hall. The Car builders have also arranged with the Board

of Directors of the Fageol Motor Company of California—subject to ratification by the stockholders—to exchange the stock of the new company to be formed, for the stock of the old company. The basis of this exchange has been unanimously approved by the Board of Directors of the Fageol Motor Company of California. It is expected that the same basis of exchange of stock will be arranged for with the Fageol Motors Company of Ohio in which Company The J. G. Brill Company is now a stockholder."

The major steps in the acquisition of the stock of each of these companies were as follows:

(1) On August 28, 1925, officers of American Car & Foundry Company and Brill Company submitted to the directors of Fageol California a proposition for the consolidation of Fageol California and Hall-Scott through the formation of a new corporation. The proposition was accepted by the directors of Fageol California subject to the approval of two-thirds of the stockholders of that company. (R. 66a)

(2) On August 29, 1925, American Car and Foundry Company and Brill Company entered into an agreement with E. J. Hall, B. C. Scott and L. S. Scott for the purchase of 667 shares of stock of Hall Scott out of a total 1000 shares outstanding at the rate of $4,500 per share. (R. 66a)

(3) On October 15, 1925, the owners of 2,470 shares of preferred stock (4,553 outstanding) and 6,974 shares of common stock (10,486 oustanding) of Fageol Ohio submitted to Brill an offer with respect to the exchange of stock of Fageol stock for stock in a new corporation to be organized. (R. 68a)

(4) On October 31, 1925, pursuant to the agreement of August 29, 1925, American Car & Foundry Securities Co., a wholly-owned subsidiary of American Car & Foundry Co., paid the sum of $2,501,962.50 to the shareholders of Hall-Scott for 556 shares of its stock and Brill paid the sum of $499,537.50 to the shareholders of Hall-Scott for 111 shares of its stock. The stock acquired was endorsed in blank and was never trans-

ferred on Hall-Scott's books and no new Hall-Scott stock certificates were issued until they were issued to taxpayer. (R. 68a-69a)

(5) On December 23, 1925, there was formed a new corporation, the American Car & Foundry Company (referred to here as taxpayer) pursuant to the plan of Woodin and Curwen. (R. 69a)

(6) At the meeting of the taxpayer's directors held on December 31, 1925, a resolution was passed approving the acquisition of the entire capital stock of Hall-Scott. All of the Hall-Scott stock was delivered to the new corporation on that date. (R. 69a)

(7) At a meeting of the taxpayer's directors held on December 31, 1925, a resolution was passed accepting the offer of the stockholders of Ohio Fageol to exchange their preferred and common stock for taxpayer's stock. This was done in January 1926. (R. 69a)

(8) The stockholders of California Fageol never approved the proposed consolidation and the stock of California was never acquired. (R. 66a)

This deficiency arose because taxpayer included in its invested capital its investment in Ohio Fageol and Hall-Scott as follows (R. 72a):

Fageol Motors Company	$1,393,445.67
Hall-Scott Motor Car Co.	4,500,000.00
	$5,893,445.67

And in spite of the fact that when American Car & Foundry Securities and Brill bought the Hall-Scott stock for $3,000,000 with the purpose (admitted by respondent) of organizing and transferring that stock to the taxpayer and by carrying out this purpose they clearly invested $3,000,000 in the taxpayer, the Commissioner included in taxpayer's invested capital only the following amounts:

Fageol Motor Company	$454,800
Hall-Scott Motor Car Co.	100,000
	$554,800

The Tax Court sustained the Commissioner on the ground that the transitory ownership of the Hall-Scott stock by American Car and Foundry Securities and Brill was to be treated as a single step and given separate tax consequences. It held, therefore, that the stock of Hall-Scott Company and Fageol Company was acquired by taxpayer in a tax-free exchange. The Court of Appeals for the Third Circuit affirmed.

Specification of Errors To Be Urged.

It is submitted the Court of Appeals erred: (Any of the following three errors will compel reversal)

1. In breaking up the steps of a complicated corporate reorganization and giving each step separate tax effects instead of viewing the reorganization as a whole and in basing its decision on the false assumption that "the contention of the petitioner . . . is necessarily based upon the premise" that the buyers "of the Hall Scott stock . . . did so as promoters for and on behalf of the taxpayer."

2. In failing to apply and completely ignoring the squarely in point decision of this Court in *Helvering* v. *Bashford,* 302 U.S. 454, and under it hold that transitory ownership of the Hall-Scott stock by American Car & Foundry Securities and Brill did not make them parties to a Section 112(b)(5)[1] reorganization.

3. In approving the sole use of the interdependency test to determine whether a complicated corporate reorganization should be treated as a single transaction.

Reasons For Granting The Writ.

1. The decision of the Court of Appeals is directly in conflict with the decision of this Court in *Helvering* v. *Bash-*

[1] Section 203(b)(4) of the Revenue Act of 1926 is involved in this case. However, since 203(b)(4) of the Revenue Act of 1926 is similar to Section 112(b)(5) of the Internal Revenue Code, the latter designation is used throughout the petition.

ford, 302 U.S. 454. Like the *Bashford* case, this case presents the familiar situation where stock of a corporation is purchased by a second corporation for transfer to a third corporation. Also, like the *Bashford* case, this case involves the reorganization provisions of the revenue acts which are generally designed to postpone recognition of gain or loss in situations where the exchange does not effectuate a material change in ownership and where instead there are merely changes in form and not in substance. The *Bashford* case was concerned with the question of whether transitory ownership of stock should be given separate tax effect in determining whether the transfer comes within Section 112(b)(3). This case concerns the question of whether transitory ownership of stock should be given separate tax effect in determining whether the transfer comes within Section 112(b)(5).

In the *Bashford* case, Atlas purchased the stock of Peerless and Union without qualification or reservation of any kind. Atlas then transferred the stock of Peerless and Union to a newly organized subsidiary. The stockholders of Peerless and Union did not participate in the contract or exchange between Atlas and the new company. The government on page 8 of its supplemental brief filed in this Court in that case termed the ownership of the stock of Peerless and Union by Atlas an "intermediate transfer" and stated "that such intermediate transfers may not be regarded as separate and distinct transactions." This Court agreed with this contention and stated:

> "Any direct ownership by Atlas and Peerless, Black Diamond and Union was transitory and without real substance; it was part of a plan which contemplated the immediate transfer of the stock or the assets of both of the three reorganized companies to the new Atlas subsidiary. Hence, under the rule stated, the above distinctions are not of legal significance." (p. 458)

In the Court below, respondent in accord with the uncontradicted evidence admitted on page 2 of his brief that American Car & Foundry Securities and Brill had purchased the Hall-Scott stock "with the purpose of organizing a corporation and of having it acquire all the stock . . . in exchange for issuance of its own stock." Also in his brief in the Court below, on page 18 thereof, respondent stated:

> "Securities Company and Brill Company intended to, and did ultimately, transfer the stock (Hall-Scott) to the taxpayer in exchange for its stock . . ."

It is on the basis of these ultimate facts that petitioner under the rule laid down by this Court in the *Bashford* case is entitled to judgment. All that this Court has to do is to apply the law of the *Bashford* case to these admitted facts. There is of course no need for this Court to go into any question of fact. Petioner's case may rest on the facts as admitted by respondent.

The facts established by the uncontradicted evidence and properly admitted by respondent make it clear that there is a conflict between the decision of the Court below and that of this Court in the *Bashford* case which the decision below ignores. Under the principle laid down by the *Bashford* case the "intermediate transfer" of the Hall-Scott stock to American Car & Foundry Securities and Brill should not be given separate tax effect in determining whether the transfer comes within Section 112(b)(5) as was done by the Court below.

2. The decision below is wrong and produces a glaringly unjust result. The Court of Appeals erred in concluding that the plan relied upon by the two purchasing companies when they purchased the Hall-Scott stock was never carried out. This is shown by the following statement of the crucial facts of the plan made on page 2 of respondent's brief in the Court below under the title "Question Presented":

> "The taxpayer issued its stock to the stockholders of two other corporations in exchange for their shares of stock in such corporations. Some of the transferors (American Car & Foundry Securities and Brill) had previously purchased some of the stock with the purpose of organizing a corporation and of having it acquire all the stock in both corporations in exchange for the issuance of its own stock. The sellers of the stock, however, were not parties to this plan." (names "American Car & Foundry Securities and Brill" inserted)

Where the Court of Appeals become confused was in including in the crucial facts of the plan, upon which the decision depends, the fact that the acquisition of the California Fageol stock was never carried out, which is irrelevant to the issue.

Petitioner is content to rest on the quoted admission of the crucial facts in the case as made by respondent. Respondent's statement makes it plain that the transitory ownership of the Hall-Scott stock by American Car & Foundry Securities and Brill was a part of a complicated corporate reorganization. As such it may not be regarded as a separate and distinct transaction and given separate tax effect as was done by the Court below.

Also the decision below perverts the purpose and intent of the profits tax law because, as is common knowledge, the theory of the invested capital credit for the excess profits tax is that a corporation is entitled to earn from 5 per cent to 8 per cent of the investment made in the corporation by its stockholders before any of its profits are treated as "excess." When American Car & Foundry Securities and

Brill bought the Hall-Scott stock for $3,000,000 with the purpose (admitted by respondent) of organizing and transferring that stock to the taxpayer and carried out such purpose they clearly invested $3,000,000 in the taxpayer. Yet under the decision, taxpayer is allowed to include in its invested capital only $100,000 for all the Hall-Scott stock acquired by it for $3,000,000. This is grossly unjust. This problem is a continuing one because the new excess profits low contains the same provision.

3. A constantly arising issue of considerable importance in the administration of the income tax law is raised by the present case.[1] This case like innumerable others involves the question of whether a series of steps is to be treated as one transaction or broken up into its several elements and each be given separate tax effects. Complicated corporate reorganizations are almost always effected in a number of steps. Almost always one step considered by itself complies with the tax-free exchange provision but the whole transaction does not. The question always arises whether the reorganization must be viewed as a whole or as a series of separate transactions. This Court has held they should be viewed as one transaction. *Helvering* v. *Southwest Co.*, 315 U.S. 199 at p. 200. A rule allowing courts below arbitrary carte blanche to treat such reorganizations either as one or separate transactions will give these cases the character of a roulette lottery.

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[1] At the present time there is pending before this Court two petitions for certiorari involving the question whether two or more steps are to to be considered one transaction: **S. Klein on the Square, Inc. v. Commissioner,** No. 152, and **Kimbell-Diamond Milling Company v. Commissioner,** No. 196. Other petitions for certiorari involving this same question previously filed are **American Bantam Car Company v. Commissioner,** filed on Feb. 10, 1950, and **National Bank of Commerce in Memphis v. United States,** filed on June 30, 1950. Both the latter petitions were denied.

The body of case law on the subject of "step transactions" has been described as "chaotic" and a "morass" and should be clarified by this Court.

Wherefore, your petitioners respectfully pray that a writ of certiorari should be granted.

All of which is respectfully submitted,

JOHN E. HUGHES
JOHN W. HUGHES
HAROLD R. BURNSTEIN

APPENDIX.

INTERNAL REVENUE CODE:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b)(5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * *

(26 U.S.C. 1946 ed., Sec. 113.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

Sec. 203. * * *

(b) * * *

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such cor-

poration, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

Treasury Regulations 110, promulgated under the Internal Revenue Code:

Sec. 33.31. *Bases of Tax Computation.*

• • •

(c) [as amended by T. D. 5245, 1943 Cum. Bull. 801, T. D. 5327, 1944 Cum. Bull. 424] *Computations.*—

• • •

(2) • • •

• • •

(iv) In the computation of average invested capital (which, under this section, may be a minus amount), the following adjustments shall be made—

(F) With respect to the stock of another member of the affiliated group held with a basis for invested capital purposes determined to be a basis other than cost, there shall be subtracted from equity invested capital otherwise computed an amount equal to such basis adjusted by an amount equal to the adjustments proper under section 115 (1) for determining earnings and profits, except that no adjustment shall be made with respect to—

• • •

(G) In the case of a member of the affiliated group the stock of which is held by other members of such group with a basis for invested capital purposes determined to be a cost basis, there shall be excluded as of the date on which such corporation became a member of the group within the meaning of section 141 (d) of the Code that portion of its equity invested capital attributable to the shares of stock so held • • •

• • •

(13) For the purpose of computing the consolidated average invested capital for the taxable year—

(i) Stock of one member of the affiliated group held by another member of that group at any time during the taxable year shall be determined to be stock held with a basis other than cost if—

• • •

(B) Such stock is held with a basis fixed by reference to its basis in the hands of a preceding owner, but not including—

• • •